

## Message Text

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INR-10 NSAE-00 TRSE-00 XMB-04 OPIC-06 SP-02  
LAB-04 SIL-01 OMB-01 SS-15 STR-07 CEA-01 DODE-00  
PA-02 NSCE-00 SSO-00 ICAE-00 INRE-00 /113 W  
-----079002 110751Z /20

O 110710Z APR 78  
FM AMEMBASSY OTTAWA  
TO SECSTATE WASHDC IMMEDIATE 6984  
INFO AMCONSUL CALGARY  
AMCONSUL WINNIPEG  
AMCONSUL TORONTO  
AMCONSUL VANCOUVER  
AMCONSUL QUEBEC  
AMCONSUL MONTREAL  
AMCONSUL HALIFAX  
AMEMBASSY PARIS

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PARIS FOR USOECD; PASS CEA, TREAS, FRB

E.O. 11652: NA  
TAGS: EFIN, ECON, CA  
SUBJECT: CANADIAN BUDGET OFFERS MODEST STIMULUS AND  
STRUCTURAL REFORM

REF: CERP 0200

1. SUMMARY: GOC BUDGET FOR FY 1978/79 WAS INTRODUCED  
IN PARLIAMENT APRIL 10. BUDGET PROPOSES MODERATE STIMULUS  
BY TEMPORARY SIX MONTH CUT IN SALES TAXES, ADDING ABOUT  
CDOLS 1.1 BILLION IN CONSUMER PURCHASING POWER, FINANCED  
ONE-THIRD BY STRONGER PROVINCES, ONE-THIRD BY CUT IN  
FEDERAL SPENDING, AND ONE-THIRD BY INCREASE IN FEDERAL  
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DEFICIT. POORER ATLANTIC PROVINCES WILL BE FULLY REIM-  
BURSED BY FEDERAL GOVERNMENT FOR THREE PERCENTAGE POINT  
SALES TAX REDUCTION. GOC WILL REIMBURSE REMAINING PROVIN-  
CES (EXCEPT ALBERTA) FOR TWO PERCENTAGE POINT REDUCTION.  
GOC WILL REDUCE EXPENDITURES BY CDOLLAR 350 MILLION FROM  
FEBRUARY ESTIMATES. BUDGET REPEAT WITH STRUCTURAL  
MEASURES INCLUDING TARIFF MEASURES, TAX INCENTIVES FOR R&D

EXPENDITURE, RAILWAY INVESTMENT AND ENERGY DEVELOPMENT, CHANGES IN REGISTERED RETIREMENT SAVINGS PLAN AND TAX TREATMENT OF FARM PROPERTY. OTHER TAX CHANGES ARE TO PROMOTE PRODUCTION OF CANADIAN FILMS. NET EFFECT OF TAX AND EXPENDITURES CUTS IS FEDERAL GOVERNMENT FINANCING REQUIREMENT OF CDOLLAR 11.5 BILLION (INCLUDING INTEREST PAYMENTS OF CDOLLAR 2 BILLION ON CANADA SAVINGS BONDS), AN INCREASE OF CDOLS 500 MILLION OVER PREVIOUS OFFICIAL ESTIMATES. FORECAST BUDGET DEFICIT ASSUMES FIVE PERCENT REAL GROWTH IN FISCAL YEAR, SIX PERCENT RISE IN GNP DEFLATOR AND SEVEN PERCENT INCREASE IN CONSUMER PRICES. END SUMMARY.

2. SHORT RUN STIMULUS: FEDERAL BUDGET INTRODUCED IN PARLIAMENT BY FINANCE MINISTER CHRETEN EVENING OF APRIL 10 OFFERS MODEST SHORT RUN STIMULUS TO ECONOMIC GROWTH. STIMULUS TAKES FORM OF GOC OFFER TO FUND TWO PERCENTAGE POINT CUT IN PROVINCIAL SALES TAXES FOR A PERIOD OF SIX MONTHS. FEDERAL COMPENSATION TO PROVINCES WILL CONSIST OF CANADIAN DOLLAR 800 MILLION TRANSFER OF PERSONAL INCOME TAXES FROM FEDERAL TO PROVINCIAL COFFERS. IN ADDITION, GOC INVITED PROVINCES TO THEMSELVES FUND A FURTHER ONE PERCENTAGE POINT CUT OVER SIX MONTHS OR TO EXTEND TWO PERCENTAGE POINT CUT FOR AN ADDITIONAL THREE MONTHS. IN RESPONSE, ATLANTIC PROVINCES, ONTARIO, AND MANITOBA HAVE AGREED TO CUT SALES TAXES THREE PERCENTAGE

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POINTS FOR SIX MONTHS. B.C. AND SASKATCHEWAN CHOSE SECOND OPTION. QUEBEC IS AS YET UNDECIDED.

3. IN RECOGNITION OF FACT THAT ATLANTIC PROVINCES LESS ABLE TO FUND ADDITIONAL REVENUE CUTS, GOC OFFERED THEM A FREE RIDE. ALBERTA (WHICH HAS NO SALES TAX) WILL NOT PARTICIPATE IN PROGRAM, BUT GAVE GOC GREEN LIGHT TO CONVEY THAT PROVINCE'S SUPPORT FOR IT IN BUDGET DOCUMENT. GOC ESTIMATES THAT CUT IN SALES TAXES WILL COME TO CANADIAN DOLLAR 1.1 BILLION AND PRICE LEVEL SHOULD BE REDUCED BY ONE PERCENTAGE POINT WHILE CUT IS IN EFFECT. GOC APPARENTLY HOPES THAT SALES TAX CUT WILL INCREASE CONSUMPTION NOT ONLY BY INCREASING REAL DISPOSABLE INCOMES, BUT BY PRODUCING ACCELERATION IN SPENDING IN ANTICIPATION OF RE-IMPOSITION OF SALES TAX.

4. STRUCTURAL MEASURES: STRUCTURAL MEASURES INCLUDED IN BUDGET RANGE FROM CHANGES IN TARIFF STRUCTURE AND COMMERCIAL POLICY TO TAX INCENTIVES FOR INVESTMENT, AND INCLUDE FOLLOWING:

A. TARIFFS AND COMMERCIAL POLICY:

--EXTENSION OF TARIFF REDUCTIONS ON SOME CONSUMER ITEMS  
INTRODUCED IN 1973 AND DUE TO EXPIRE ON JUNE 30, 1978.  
EXTENSION IS TO CONTRIBUTE TO REDUCING INFLATION RATE;

--WITHDRAWAL OF BRITISH PREFERENTIAL TARIFF RATE FROM  
CERTAIN GOODS IMPORTED FROM UK AND IRELAND.  
--TO ASSIST CANADIAN PRODUCERS, INCREASES IN MFN RATES  
PROPOSED FOR CERTAIN CHEMICALS AND INDUSTRIAL TIRES AND  
TUBES.

--CONTINUED EFFORTS TO ALTER THROUGH NEGOTIATION GATT

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O 110710Z APR 78  
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COMMITMENTS WHICH CURRENTLY PREVENT CANADA FROM RAISING  
DUTIES ON FRUITS AND VEGETABLES.

--CONTINUED ACTIVE PARTICIPATION IN MTN.

B. TAX REFORM:

--R AND D INCENTIVES: AT PRESENT, COMPANIES ARE ALLOWED  
TO WRITE OFF 100 PERCENT OF ALL R AND D CAPITAL AND

OPERATING EXPENDITURES. R AND D INVESTMENTS ARE ALSO ELIGIBLE FOR FIVE - TEN PERCENT FEDERAL TAX CREDIT. BUDGET PROPOSES THAT, FOR TEN YEARS, TAXPAYERS BE ALLOWED TO DEDUCT FROM INCOME AN ADDITIONAL FIFTY PERCENT OF R AND D EXPENDITURES. DEDUCTION APPLIES TO CAPITAL AND CURRENT EXPENDITURES INSOFAR AS THEY EXCEED AVERAGE OF UNCLASSIFIED

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PRECEDING THREE YEARS.

--CAPITAL COST ALLOWANCE FOR RAILWAY INVESTMENTS WERE INCREASED. PROPOSAL CONSISTS OF ADDITIONAL DEPRECIATION ALLOWANCE OF SIX PERCENT PER YEAR FOR FIVE YEARS FOR MOST CAPITAL EXPENDITURES ON RAILWAYS.

--ENERGY DEVELOPMENT PROMOTED BY TREATING PLANTS UPGRADING HEAVY OIL AS MANUFACTURING FACILITIES ELIGIBLE FOR ACCELERATED DEPRECIATION AND LOWER TAX RATES. DEPLETION ALLOWANCE FOR SPENDING ON EQUIPMENT FOR "TERTIARY" RECOVERY OF OIL WILL BE INCREASED TO FIFTY PERCENT FROM THIRTY-THREE PERCENT. EARNED DEPLETION ALLOWANCES FOR TERTIARY RECOVERY EQUIPMENT AND FOR LAND ACQUIRED FOR BITUMINOUS COAL SANDS MINING PROJECTS MAY BE APPLIED TO A MAXIMUM OF FIFTY PERCENT OF TOTAL INCOMES. (CURRENT PROVISIONS PERMIT DEPLETION TO BE APPLIED ONLY TO RESOURCE PROFITS UP TO 25 PERCENT.)

--GOC UNDERLINED ITS PLANS TO CONTINUE CONSULTATIONS WITH PROVINCES ON MINERAL TAXATION POLICY.

--CHANGES IN PERSONAL TAX PROVISIONS. OPTIONS FOR CONVERSION OF REGISTERED RETIREMENT SAVINGS PLANS (RRSP) INTO LIFE-TIME ANNUITIES HAVE BEEN INCREASED. TRANSFER OF PROPERTY BETWEEN SPOUSES WILL NO LONGER ENTAIL CAPITAL GAINS TAXES. INHERITED LAND FROM INCORPORATED FAMILY FARMS NO LONGER SUBJECT TO TAX (PRESENTLY, ONLY UNINCORPORATED FAMILY FARMS ARE TAX EXEMPT).

--SPECIAL TAX WRITE OFFS WILL BE PROVIDED FOR PRODUCTION OF CERTAIN CANADIAN FILMS CERTIFIED BY AUTHORITIES.

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C. OTHER STRUCTURAL MEASURES: BUDGET NOTES THAT FEDERAL/ PROVINCIAL CONSULTATIONS (INITIATED AT FEBRUARY SUMMIT) ON STRUCTURAL ANALYSES OF 22 SECTORS WILL CONTINUE.

EFFORT UNDERWAY TO REDUCE BURDEN ON BUSINESS OF GOVERNMENT REGULATION AND TO REDUCE TOURISM DEFICIT. FOOD AND AGRICULTURAL POLICIES CITED AS BEING UNDER REVIEW.

5. FISCAL IMPACT OF BUDGET: GOC NOW ESTIMATES FY 1977/78 FINANCING REQUIREMENTS AT CDOLLAR 8.5 BILLION, DOWN CDOLLAR 300 MILLION FROM PREVIOUS ESTIMATE DUE TO SPENDING SHORTFALL. PRE-BUDGET FORECAST OF FINANCING REQUIREMENT FOR FY 1978/79 WAS CANADIAN DOLLAR 11 BILLION. FUNDING OF PROVINCIAL SALES TAX CUTS ESTIMATED TO COST GOC ABOUT CANADIAN DOLLAR 800 MILLION. HOWEVER, NEW BUDGET REDUCES EXPENDITURE CEILINGS BY CANADIAN DOLLAR 350 MILLION FROM CDOLLAR 48.8 MILLION SHOWN IN PRELIMINARY EXPENDITURE ESTIMATES PREPARED IN FEBRUARY (OTTAWA 1020). THUS, GOC EXPECTS TOTAL FINANCING REQUIREMENT OF ABOUT CDOLLAR 11.5 BILLION (INCLUDING INTEREST PAYMENTS ON CANADA SAVINGS BONDS) IN FY 1978/79. THIS REPRESENTS RELATIVELY SMALL (CDOLLARS 500 MILLION) INCREASE IN PRE-BUDGET FORECAST OF FINANCING. PROJECTED FINANCING REQUIREMENTS ASSUMES GROWTH OF REAL GNP CLOSE TO FIVE PERCENT, SIX PERCENT RISE IN GNP DEFLATOR AND SEVEN PERCENT INCREASE IN CPI. GOC EXPECTS ONLY MODEST DECLINE IN UNEMPLOYMENT RATE.

6. POLITICAL OPPOSITION ATTACKED BUDGET AS ONE OF "HALF MEASURES", INSUFFICIENT TO PROMOTE ADEQUATE CONSUMER CONFIDENCE, AND POLITICALLY INSPIRED TO GIVE ECONOMY A LITTLE LIFT ONLY LONG ENOUGH TO GET GOVERNMENT THROUGH THE UPCOMING ELECTIONS. CRITICISM RAN ALONG LINES EXPECTED TO BE USED BY PARTIES ON ECONOMIC ISSUES IN CAMPAIGN.

7. TORY FINANCIAL CRITIC SINCLAIR STEVENS SAID CDOLS 1.1

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BILLION SALES TAX CUT WAS NOT SUFFICIENT TO BUILD A BASIS FOR PROSPERITY; WHAT WAS NEEDED WAS A CDOLLARS 2.2 BILLION TAX CUT COUPLED WITH AT LEAST A CDOLLARS 2 BILLION REDUCTION IN FEDERAL SPENDING AND CUTBACK IN SIZE OF PUBLIC SERVICE EMPLOYERS (AS PROPOSED BY PC).

8. STEVENS USED OCCASION TO ATTACK FINANCE MINISTER CHRETIEN (WHO IS LIKELY TO BE PRIME OPPOSITION TARGET IN CAMPAIGN) FOR HIS "INEPT" HANDLING OF THE ECONOMY AND IN PARTICULAR OF THE CANADIAN DOLLAR. STEVENS SAID ONE PERCENTAGE POINT INCREASE ALL AT ONCE WAS NEEDED IN THE BANK RATE TO MAKE IMPACT ON FOREIGN EXCHANGE MARKETS, BUT THAT TWO INCREASES OF BANK RATE WITHIN THREE WEEKS OF ONE HALF OF ONE PERCENT EACH HAD UNDERMINED CONFIDENCE IN THE DOLLAR. IN ADDITION, HE SAID U.S. DOLLARS 750 MILLION UNCLASSIFIED

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GOC BORROWING IN NEW YORK MARKET WAS TOO SMALL, BUT AT LEAST U.S. DOLLARS 1.5 TO 2.0 BILLION HAD BEEN NEEDED. AS A RESULT, HE PREDICTED GOC SOON WOULD HAVE TO BORROW AGAIN, FURTHER UNDERMINING CONFIDENCE.

9. STEVENS SAID THAT IN FACT BUDGET WOULD NOT BE IN THE FORM IT WAS "BUT FOR THE INSISTANCE OF WASHINGTON" (APPARENTLY A REFERENCE TO THE SEC) BECAUSE OF THE NEED TO HAVE A PRESENTABLE FISCAL STATEMENT IN THE NEXT GOC BORROWING PROSPECTUS AND THAT BUDGET HAD BEEN DICTATED BY "WASHINGTON AND WALL STREET BARONS" WHO MIGHT BE ASKED TO LOAN MORE MONEY TO GOC.

10. STEVENS ALSO SAID SALES TAX REDUCTION WOULD LAST ONLY UNTIL OCTOBER, JUST WHEN SEASONAL UNEMPLOYMENT IN CANADA WOULD BE RISING. HE CONCLUDED THIS WAS AN ELECTION BUDGET, NOT AN ECONOMIC BUDGET, AND "IN THREE MONTHS" (I.E., AFTER THE ELECTIONS) IT WILL BE COMPLETELY FORGOTTEN.

11. NDP LEADER ED BROADBENT ECHOED MANY OF THE SAME POINTS, ADDING THAT PUBLIC SECTOR INVESTMENT SHOULD HAVE BEEN GREATLY INCREASED AND THE SALES TAX CUT MADE

PERMANENT.

12. COMMENT: DESPITE PREDICTABLE CARPING BY OPPOSITION POLITICIANS, FEDERAL BUDGET IS BALANCED POLITICALLY, IF NOT FINANCIALLY. FOR THE WEST THERE ARE TAX INCENTIVES FOR ENERGY DEVELOPMENT AND CHANGES IN TAXATION OF FARM PROPERTY. FOR THE EAST THERE IS FULL FEDERAL FUNDING OF SALES TAX CUT. FOR THE OLD THERE IS INCREASED FLEXIBILITY IN CONVERSION OF RRSPS, AND FOR YOUNG, CONTINUED SPENDING ON YOUTH EMPLOYMENT AND CANADA WORKS PROGRAMS. PROPOSALS UNCLASSIFIED

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TO SEEK CONCESSIONS OF REAL VALUE IN MTN AND TO RAISE TARIFFS ON SOME ITEMS WILL PLEASE BOTH EXPORTERS AND PRODUCERS FOR DOMESTIC MARKET. THOSE SEEKING FASTER GROWTH HAVE A TEMPORARY TAX CUT WHICH SHOULD HELP ACHIEVE THIS END, WHILE FISCAL CONSERVATIVES (AND THE INTERNATIONAL FINANCIAL COMMUNITY) MAY BE COMFORTED BY FACT THAT INCREASE IN BUDGET DEFICIT WAS SMALL. ONTARIO AND QUEBEC SHOULD BENEFIT FROM INCENTIVES FOR R AND D EXPENDITURE.

13. MAIN RISK IN NEW BUDGET IS POSSIBILITY THAT REAL GNP GROWTH IN FISCAL YEAR WILL FALL FAR SHORT OF FIVE PERCENT ASSUMED IN REVENUE PROJECTIONS AND THUS THAT FEDERAL FINANCING REQUIREMENT WILL SUBSTANTIALLY EXCEED CANADIAN DOLLAR 11.5 BILLION FORECAST. INTERNATIONAL COMMUNITY, INCLUDING EXCHANGE MARKETS, COULD WELL REACT ADVERSELY TO THIS PROSPECT. (FURTHER ANALYSIS OF POLITICAL/ECONOMIC IMPLICATIONS OF BUDGET FOLLOWS SEPTELS.) ENDERS

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## Message Attributes

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